

## Internal Revenue Service

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Date:

December 18, 2006

In Re:

### LEGEND:

City =

State =

Program =

Dear :

This letter responds to your ruling request submitted on behalf of the City by a letter dated November 26, 2003, as supplemented on February 19, 2004, September 5, 2006, and October 30, 2006. Your request relates to whether the City is required to file information returns for payments made under the Program described below.

### BACKGROUND

The City is a municipal government incorporated under the laws of State. The City implemented the Program to reduce the financial hardship that can occur when a property owner is ordered to remove dead or dying trees, which are identified by the City as posing an immediate threat to public health and safety.

The Program has two different systems of assistance: one for owner-occupants (hereinafter "Residents") and one for investors of rental property (hereinafter "Investors"). Under the Program, the City classifies dead or dying trees and issues a removal order. Residents must submit proof of ownership of the property and total household income to the City in order to obtain assistance. Investors must submit proof of ownership of the property and total household income of their tenants. Subsequently, Residents and Investors solicit bids from contractors to remove the trees, and the City

selects a contractor among the solicited bids. Upon inspection of the completed work, the City makes payment directly to the contractor. The amount of assistance is determined by the total household income level of the Residents or the tenants of Investors.

Payments made to Residents are grants, while in the case of payments made to Investors, the City imposes a lien on the rental property for some or all of the amount of assistance provided. When the Investor sells or changes the title of the property, the assistance is repaid and the lien is removed.

## LAW AND ANALYSIS

Section 6041 of the Internal Revenue Code (hereinafter the "Code") requires all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year, to file an information return with the Internal Revenue Service (hereinafter the "Service") and to furnish an information statement to the payee.

Section 1.6041-1(c) of the Income Tax Regulations (hereinafter the "Regulations") provides that payments are fixed when they are paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. Section 1.6041-1(a)(2) requires a payor to report section 6041 amounts on Form 1099. Payments that are not fixed or determinable are not subject to information reporting under section 6041.

The payments of compensation (and other amounts) required to be reported under section 6041 are those includible in gross income under section 61. Accordingly, in order to decide whether the City is required to furnish an information return to the property owners, it is necessary to examine whether the payments are includible in gross income.

Section 61(a) of the Code and the Regulations thereunder define gross income to mean all income from whatever source derived. See also section 1.61-1(a) of the Regulations. However, section 1.61-6(b) provides that certain gains or losses realized on the sale or exchange of property, including involuntary conversions under section 1033, are not "recognized," or included in gross income, at the time of the transaction. The gain or loss from such sale or exchange is generally recognized at some later date.

Section 1033(a)(1) provides that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use

to the property so converted, no gain shall be recognized. Section 1033(a)(2)(A) provides, in part, that if such property is converted into money and the taxpayer timely purchases other property similar or related in service or use to the property so converted, then, at the election of the taxpayer, the gain shall be recognized only to the extent that the amount realized on such conversion exceeds the cost of such other property.

Section 1033 requires a broad construction to effectuate its purposes. See E.R. Hitchcock Co. v. U.S., 514 F.2d 484, 486 (2<sup>nd</sup> Cir. 1975); Loco Realty Co. v. Commissioner, 306 F.2d 207, 215 (8<sup>th</sup> Cir. 1962). Amounts realized from an involuntary conversion have been held to include severance damages (damages to property remaining after condemnation) and moving expenses. E.R. Hitchcock Co., 514 F.2d at 486-87.

In this case, the property owners received the costs of the tree removal services solely as a result of the City's order to remove the dead or dying trees. But for the conversion, the property owners would not have realized the payments from the City. Accordingly, we conclude that the payments are amounts realized from an involuntary conversion within the meaning of section 1033.

As explained above, gains, profits, and income under section 6041 are reportable to the extent that they are fixed and determinable at the time the payment is made. See section 6041(a) of the Code. When section 1033 applies, the extent to which gain must be recognized in the year of disposition is contingent on the section 1033 election. Taxpayers can make this election up to two years after the year in which the any portion of the gain is realized. Because the City does not possess the information necessary to determine what portion, if any, of the assistance payments are income to the property owners, the payments are not fixed or determinable under section 6041, and the City is not required to file information returns with the Service or to furnish information statements to the property owners with respect to the payments. We express no opinion regarding whether all or any portion of the payments would be excluded from gross income in the year of receipt, without regard to section 1033.

The City's direct payments to contractors raise an additional issue. Section 1.6041-1(e) (the "Middleman Rules") of the Regulations provides:

(e) Payment made on behalf of another person--(1) In general. A person that makes a payment in the course of its trade or business on behalf of another person is the payor that must make a return of information under this section with respect to that payment if the payment is described in paragraph (a) of this section and, under all the facts and circumstances, that person—

(i) Performs management or oversight functions in connection with the payment (this would exclude, for example, a person who performs mere administrative or ministerial functions such as writing checks at another's direction); or

(ii) Has a significant economic interest in the payment (i.e., an economic interest that would be compromised if the payment were not made, such as by creation of a mechanic's lien on property to which the payment relates, or a loss of collateral).

Under the facts provided, it appears that the City exercises management or oversight functions with respect to payments made to contractors on behalf of the property owners. The City selects a contractor and inspects the work performed by the contractor prior to making payment. See section 1.6041-1(e)(5) of the Regulations.

Accordingly, if the City makes a direct payment to a contractor pursuant to the Program, the City is required to file an information return with the Service and to furnish an information statement to the contractor. Payments to contractors would be reported on Form 1099-MISC, with the amount reported in box 7 as "Nonemployee Compensation."

## CONCLUSION

For these reasons, we conclude that the City is not subject to the information reporting requirements of section 6041 with respect to the payments distributed to the property owners under the Program but that information reporting is required with respect to direct payments to contractors, unless the recipient is a corporation or other specified entity, payment to which is exempt under section 1.6041-3(p) of the Regulations.

This document may not be used or cited as precedent. See section 6110(k)(3) of the Code.

Sincerely,

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John Aramburu  
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Branch 5  
Associate Chief Counsel  
(Income Tax & Accounting)